Written Statement of the
National Petrochemical & Refiners Association

delivered by
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before the
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concerning
Gasoline: Supply, Price, and Specifications

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Chairman Barton, Ranking Member Dingell, and members of the Energy & Commerce Committee, NPRA, the National Petrochemical & Refiners Association, appreciates the opportunity to present its views on the current gasoline market and the role of the domestic refining industry. I am Bob Slaughter, NPRA's President. Our testimony today will concentrate on factors directly impacting the current and projected gasoline supply and the specifications which refiners have been or are obligated to achieve. As you know, NPRA is a national trade association with 450 members, including those who own or operate virtually all U.S. refining capacity, as well as most of the nation's petrochemical manufacturers with processes similar to those of refiners.

INTRODUCTION

We may have reached a point in history at which the future welfare of our nation depends on maintaining a stable supply of transportation fuels and other forms of energy at reasonable prices. It very well could also depend upon achieving better mutual understanding between the domestic energy industry (petroleum, natural gas, and refined products) and the public—a community greatly influenced by the deeds and words of Congress.

The state of the gasoline market today reflects supply and demand, and the arithmetic is not complicated. What is happening is what the textbooks say should happen. With domestic demand for refined products accelerating and outpacing our ability to meet those needs with domestic supplies, coupled with the ever-increasing global demand for these same products, market volatility will continue. Although this situation is unsatisfactory, it can only be alleviated with increased supply. In the meantime, policy makers must resist turning the clock backwards to the failed policies of the past. Experience with market interference in the 1970s and 1980s such as price constraints, allocation controls, and punitive taxes demonstrate not only the failure of these programs, but also their adverse impact on both fuel supplies and consumers.

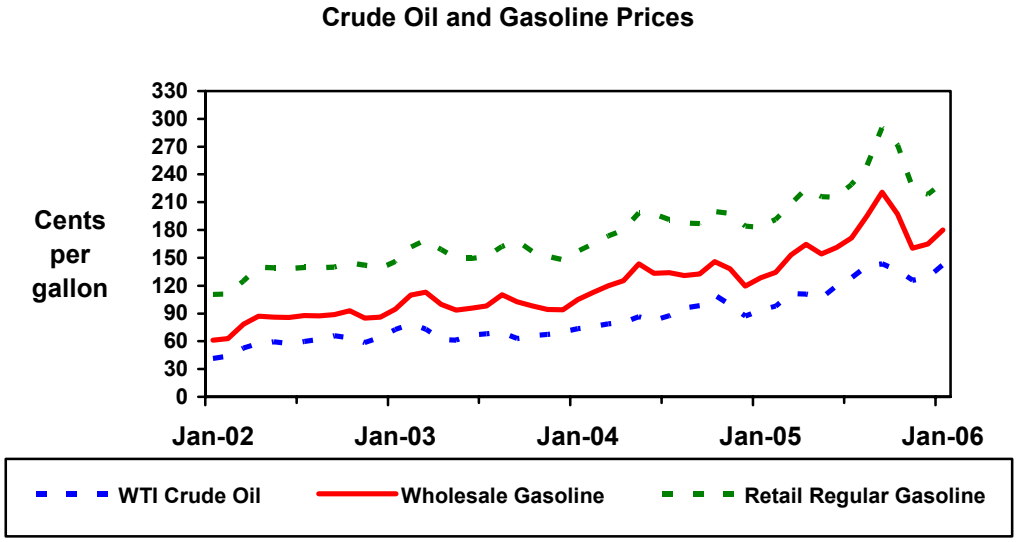
To summarize our message, NPRA urges policymakers in Congress and the Administration to encourage domestic production of an abundant supply of petroleum, oil products, and natural gas for U.S. consumers. Rather than engaging in a fruitless search for questionable quick-fix solutions, or even worse, taking actions that could be harmful, we urge Congress, the Administration, and the public to exercise continued patience with the free market system as the nation adjusts to a volatile global energy market. The nation's refiners are working hard to meet rising demand while complying with extensive regulatory controls that affect both our facilities and the products we manufacture.

Throughout this statement, NPRA will outline and discuss key factors that provide perspective on the current and future situation the nation confronts regarding the supply of and demand for refined petroleum products.

REFINED PRODUCT MARKET FUNDAMENTALS

Any discussion of the domestic refining industry must begin with a description of three fundamental facts that guide refined product markets. These fundamentals are that: 1) the cost of crude oil is the primary driver of the cost of refined product; 2) the balance between supply of and demand for refined products is extremely tight, and; 3) free-market pricing balances the system to the maximum benefit of consumers.

In June of 2005 the U.S. Federal Trade Commission released a landmark study titled: "Gasoline Price Changes: The Dynamic of Supply, Demand and Competition." This study determined that "Worldwide supply, demand, and competition for crude oil are the most important factors in the national average price of gasoline in the U.S." and "the world price of crude oil is the most important factor in the price of gasoline. Over the last 20 years, changes in crude oil prices have explained 85 percent of the changes in the price of gasoline in the U.S." As the chart below clearly demonstrates, the price of crude oil leads the price of wholesale and retail gasoline.



Source: EIA

In addition to the cost of crude oil, the tight balance between refining capacity and refined product demand must be taken into account when to understand price changes. Refiners have been steadily expanding capacity at facilities in order to keep pace with ever-growing demand. Over the past twelve years U.S. refining capacity has increased by over 2 million barrels/day (b/d), the rough equivalent of a new average-size refinery every year. In spite of this growth, refinery utilization rates remain extraordinarily high, often approaching 98% during the summer months. These high rates of utilization reflect the thin margin between supply and demand, which causes even moderate disruptions in the system to be reflected in significant price changes. In addition, the major event of 2005, Hurricanes Rita and Katrina's disruption of key U.S. refined product pipeline service and the destruction of significant portions of Gulf Coast refining assets, caused a temporary but considerable spike in transportation fuel prices.

In spite of the serious damage these storms inflicted on the domestic refining industry, no significant, long-lived transportation fuel shortage occurred during this period. The rapid return to service of significant portions of the transportation fuels industry may be attributed to several factors: quick action by the federal government to waive temporarily regulatory requirements and release crude oil from the Strategic Petroleum Reserve; the

efforts of the dedicated employees of the industry, as well as their employers, who managed to return significant assets to service in a short time; and importantly, higher prices. Increased prices, which averaged over $3.00/gallon nationwide for a brief period, moderated demand and attracted a record amount of refined product imports. As demand declined, imports entered the fuel system, while facilities in areas unaffected by the disaster ramped-up production to provide products for the affected areas. Subsequently, prices moderated and returned to pre-storm levels by the end of November.

Without an increase in price, there would have been little incentive to attract increased amounts of refined products to the United States, or to run refining facilities outside of the affected area at higher utilization rates. Without an increase in prices, long-lived and wide-spread fuel shortages may have occurred. In short, the market worked, to the benefit of consumers and the national economy.

DOMESTIC REFINING CAPACITY: WORKING TO MEET DEMAND AND IMPROVE THE ENVIRONMENT

148 refineries currently operate in the United States, producing record volumes of some of the cleanest transportation fuels in the world. These refineries, located in 33 states, have a combined capacity of over 17 million barrels per day (b/d) and, as previously stated, often operate at extremely high utilization rates, which approach 98% during the peak driving season. These figures are far above the 82% average utilization rate of other manufacturers. Despite these significant efforts, U.S. product demand continues to outstrip domestic supply. Imports now account for 10% of the gasoline used by U.S. consumers. Regionally, this figure is higher, as in the case of the Northeast, where imported products account for over 20% of total supply. In light of the strong demand for gasoline and other petroleum products, domestic refiners have worked hard to expand existing facilities. Over the past ten years, domestic refining capacity has increased substantially, by an average of 177,000 barrels per day (b/d) of production each year. In simpler terms, this means that the U.S. refining industry has added the equivalent of one new, larger than average refinery, each year for the past decade.

Looking forward, the industry has announced publicly that over 1.4 million b/d in new capacity is slated to come online in the next few years. Some estimates project a possible increase of nearly 1.7 million b/d of capacity over the same time frame. With these expansions, total domestic capacity will reach an all time high as shown in Attachment I. It remains doubtful, however, that these expansions will be sufficient to meet expected U.S. demand growth, and the nation's continued dependence on imports of finished product and blendstocks will continue.

Capacity expansions have occurred and will continue despite difficult and time-consuming obstacles, including complex permitting requirements and reviews, uncertainties involving the New Source Review program, increasingly stringent environmental requirements, and the difficulties of attracting sufficient investment in one of the most capital-intensive industries. NPRA continues to believe that encouraging the growth of domestic refining capacity is a vital component of U.S. energy policy.

MERGERS AND ACQUISITIONS HAVE RESULTED IN INCREASED CAPACITY AND COMPETITION

Much has been made of the fact that a new grassroots refinery has not been built in the United States in over thirty years. There are compelling reasons why: obstacles to permitting and constructing such a facility include enormous start-up capital requirements, environmental regulations, a history of low refining industry profitability, and the "Not In My Backyard" (NIMBY) public attitude. Equally important, costs to construct a new grassroots refinery would require an investment averaging $17,000 per daily barrel of capacity and, at a minimum, would take ten years to complete. On the other hand, capacity expansions at existing facilities cost in the range of $9,000 to $12,000 per daily barrel and can be completed in 3 to 4 years. In short, expansions can help meet demand more quickly and cost effectively than construction of a new, green-field refinery complex. This means more fuel for consumers in a shorter time period than a hypothetical new refinery could provide.

Significantly, while the industry has not constructed new grassroots facilities, improved management techniques and technological advances allow existing facilities to produce ever

greater amounts of refined product. As previously mentioned, refiners have added significant capacity at existing sites. In 1981, the average refinery in the United States had approximately 57,000 b/d of crude oil distillation capacity. Today, the average refinery has a capacity of over 110,000 b/d. Due to high capital requirements and increasing environmental restrictions, the industry closed small, inefficient facilities and has relied on economies of scale to save on construction costs and bring new capacity on line more quickly through expansion at existing sites.

In addition, refiners have also made substantial investments in technologically advanced process units that have increased the yield of gasoline and other valuable "light end" products from the same amount of raw crude input. Further, similar investments have been made in units designed to process a wider slate of crude oil, enabling the production of light products from heavier and sour crude oil feedstocks. Lacking these mergers and acquisitions, some of the individual refineries now operating might not have remained economically viable and the capacity expansions simply could not have been accomplished. One such example is Sunoco's refinery complex in the metropolitan Philadelphia area which now has over 550,000 barrels/day of capacity. If Sunoco were unable to operate these facilities as a synergistic unit, this production might not be available for consumers. Phillips Petroleum's (now ConocoPhillips) acquisition of the Tosco refinery system increased capacity and maintained refinery viability on a nation-wide basis, as did Tosco's initial purchase of underperforming facilities. Additionally, Valero Energy Corporation has increased the productive capacity of the refineries it has acquired by an aggregate of nearly 400,000 barrels per day over the past several years and plans more extensive expansions in the future. An examination of other mergers and acquisitions tells the same story: refineries have been kept operating and have often been expanded as the result of mergers and acquisitions.

REFINED PRODUCT PRICING: CRUDE OIL & COMPETITION

Two important factors must be kept in mind when examining the price of refined products. First, the cost of crude oil is the single greatest driver of petroleum product prices. In June of 2005 the U.S. Federal Trade Commission released a landmark study titled: "Gasoline Price Changes: The Dynamic of Supply, Demand and Competition." This study determined that "Worldwide supply, demand, and competition for crude oil are the most important factors in

the national average price of gasoline in the U.S." and "the world price of crude oil is the most important factor in the price of gasoline. Over the last 20 years, changes in crude oil prices have explained 85 percent of the changes in the price of gasoline in the U.S." According to EIA data, crude oil constitutes 55% of the cost of a gallon of gasoline, refining 22%, taxes 19% and distribution and marketing 4%. Secondly, the refining industry is robustly competitive. Some critics of the industry argue that recent mergers have reduced competitiveness and led to an increase in fuel prices. This assertion is simply wrong. The U.S. refining industry is highly competitive. Fifty-four refining companies, hundreds of wholesale and marketing companies, and more than 165,000 retail outlets compete in the U.S. market. The largest U.S. refiner accounts for just 13% of the nation's total capacity, and large integrated companies own and operate only about 10% of retail outlets. (For comparison, Archer Daniel Midland, the largest producer of fuel ethanol in the U.S., controls nearly 25% of the U.S. ethanol market.) No one company, or group of companies, sets gasoline prices. Rather, the laws of supply and demand drive competitive behavior and determine pricing in the U.S. refining industry.

REFINERS REJECT AND CONDEMN IMPROPER PRICING PRACTICES

The tight gasoline markets of the past several years have led to dozens of investigations of the refining industry at the state and federal levels. In each case, the industry has been cleared of wrongdoing. Today, as then, allegations of refiner price-fixing, price-gouging, and other illegal pricing practices are patently false.

Most recently, the Attorney General of Nebraska appointed a task force to investigate prices in that state. In a report issued in January 2006, the task force found that "hurricanes in fall 2005 functioned similarly to OPEC supply restrictions, producing higher prices, lower output, and elevated profits…" Referencing price movements in recent years the report notes that, "increases in the price of a barrel of oil accounted for 62.5 percent of the rise in gasoline prices between June 2004 and October 2005. Declines in refinery capacity utilization and increases in the share of oil imported accounted for the rest of the difference." Additionally, the task force concluded that

similar studies at the federal and state level, "have not found violations of law, and they generally have found competitive markets affected by worldwide conditions."

Another study, conducted by the Office of the Attorney General of Florida, examined price increases in that state in 2004 and found that the major factors affecting prices in that state were: "consumer demand for gasoline," "refinery capacity," "refinery utilization," "inventories," "supply issues," and "lagged response in gasoline imports." Importantly, the study found no evidence of anticompetitive behavior.

These reports repeat the findings of numerous others, including a 9-month FTC investigation into the causes of price spikes in local markets in the Midwest during the spring and summer of 2000. At the conclusion of that investigation FTC Chairman Robert Pitofsky (a recognized expert in antitrust law) stated, "There were many causes for the extraordinary price spikes in Midwest markets. Importantly, there is no evidence that the price increases were a result of conspiracy or any other antitrust violation. Indeed, most of the causes were beyond the immediate control of the oil companies."

NPRA regrets that the results of these investigations, and the findings of those now being requested, have not been and most likely will not be announced with the same enthusiasm and media attention given to news of their initiation.

ETHANOL & MTBE: A CASE STUDY IN POLICY IMPACTS

Recently, refiners undertook and completed annual turnarounds to prepare for the changeover from wintertime to summertime fuel blends. An unexpected complication for this year's efforts was the need for additional maintenance at facilities damaged by Hurricanes Katrina and Rita, or in the case of one major facility, an accident. In addition, there was a need for deferred maintenance at those facilities originally scheduled for repair work during late summer/early fall of 2005, but which operated at higher rates of utilization and continued to produce fuel for consumers in the aftermath of these storms, while other refineries were shut for storm-related repairs.

While these events could not have been predicted and both industry and government worked diligently to minimize their impacts, the fact remains that both direct actions and overt inaction by the federal government can impact and complicate the supply picture. The results of these policy decisions can and do influence marketplace conditions and volatility. For example, select provisions from the Energy Policy Act of 2005 created marketplace conditions that placed increased strain on the nation's transportation fuels supply.

Although The Energy Policy Act of 2005 eliminated the 2% oxygenate requirement for federal RFG, the act did not provide defective product limited liability relief for MTBE. Further, the rules implementing the removal of the 2% oxygenate requirement were published by EPA just this week, leaving refiners in regulatory limbo regarding RFG and the 2% oxygenate requirement. Refiners were thereby forced to make decisions regarding the transition from the production of wintertime to summertime fuels (required by federal environmental law) in the February/March 2006 timeframe. This situation evidently encouraged many refiners to move ahead quickly to remove MTBE from the fuel supply, to ensure that summertime 2006 RFG would still contain 2% oxygenate to ensure compliance with EPA regulations. This rapid MTBE removal/ethanol switch had been predicted by many industry observers, and Congress was informed on multiple occasions that the failure to adopt MTBE limited liability could impact supply. The result was considerable (but clearly anticipated) pressure on ethanol supply and fuel distribution infrastructure. It is with some irony that we note that those who demanded that MTBE be banned and removed from gasoline as soon as possible are now questioning the actions of the refining industry as it attempts as smooth as possible a transition to summertime RFG while complying with the renewable fuels (ethanol) mandate also enacted in the Energy Policy Act of 2006.

This substantial increase in demand for ethanol due to MTBE replacement and the mandate caused prices for the blendstock to rise rapidly. At the same time, the logistical challenges of changing from gasoline blended with MTBE to gasoline blended with ethanol (as well as transporting the ethanol to areas for the first time) resulted in unique challenges for a few wholesalers and retailers. Refiners, as well other participants in the transportation fuels industry, worked very hard to minimize these impacts, but they occurred nonetheless. The recent market disruptions were very limited and addressed in short order, and the system is currently adjusting to significantly reduced MTBE use. The experience demonstrates,

however, that Congress, in spite of being informed by industry and outside experts and observers, often fails to consider fully the fuel supply impacts of legislation and implementing regulations.

OTHER SUPPLY IMPACTS OF REGULATIONS

Other significant government intervention and regulations, especially environmental requirements, have had a major impact on fuel supplies. Unlike most industries, refiners comply with regulations for both their product fuels and for their facilities. In essence, the industry is impacted doubly by many environmental programs and faces numerous other regulatory burdens simultaneously as illustrated by the attached Fuels Timeline (see Attachment II). While refiners support and encourage continued environmental progress, NPRA believes that policymakers have tended to overlook and take for granted the supply side of the environmental-energy equation. It is imperative, in our opinion, that determining the impact on supply must be fully embedded in the policy-making process. In working with policymakers on improvements to fuels and facilities, NPRA has often commented that industry needs time, flexibility or more realistic standards to minimize negative impacts on fuel supply. Policymakers, however, often opt to promulgate regulations that are "technology forcing," constructed with limited and often theoretical "margins of safety," and requiring implementation in the shortest time possible—all without adequate attention to fuel supply impacts.

NPRA characterizes this current environmental agenda as a "regulatory blizzard," consisting of about a dozen new federal programs from 2006 – 2012 (see Attachment III). The majority of these regulations will have a direct impact on supply. Unfortunately, regulators have not properly sequenced or coordinated the implementation of these requirements, literally stacking them one on top of the other. Current fuel markets reflect, in many aspects, the confluence and impacts of these multiple fuel and stationary source requirements.

TAKING FUEL SUPPLY FOR GRANTED

NPRA had developed several supply-oriented recommendations to increase supply as the Energy Policy Act of 2005 was debated. Specifically, the Association recommended that

Congress repeal the 2% oxygenation requirement for federal RFG; avoid a federal ban or mandatory phase-out of MTBE; resist calls for an ethanol mandate; extend limited product liability protection to MTBE; avoid unnecessary changes in fuel specifications; and take steps to increase natural gas production and supply. Unfortunately, political considerations resulted in the exclusion of most recommendations as part of the Energy Policy Act of 2005.

Our recommendations were supported by two landmark refining studies issued by the National Petroleum Council (NPC), an advisory group to the Department of Energy. The NPC issued a report on the state of the refining industry in 2000, urging policymakers to pay special attention to the timing and sequencing of any changes in product specifications. Failing such action, the report cautioned that adverse fuel supply ramifications could result. Unfortunately, this warning has been almost totally ignored, resulting in the market volatility we have experienced over the past few years.

On June 22, 2004, former Energy Secretary Abraham asked the NPC to update and expand its refining study and a report was released December 2004. The June 22, 2004 NPC report included the following recommendations: immediate implementation of comprehensive New Source Review reform; revision of the NAAQS compliance deadlines and procedures to take full advantage of emission reduction benefits from current clean fuels and engine programs; caution in implementation of the ultra low sulfur diesel regulations; limited liability protection against defective product claims for MTBE; further study of the boutique fuels issue and approval of new fuels only when cost effective relative to other emission reduction options; regulations based on sound science, cost effectiveness, and energy impacts; streamlined permitting; and several other proposals. Few of the NPC recommendations have been implemented; frankly speaking, policymakers and opinion leaders have almost totally ignored the findings of these important reports.

CONGRESS SHOULD RESIST CHANGES IN CURRENT FUEL SPECIFICATIONS

As illustrated by the NPRA Regulatory Blizzard and Fuels Timeline cited previously, refiners face numerous challenges and fuel specification deadlines. Further complicating this picture by adding new programs, or even eliminating existing ones, will not benefit

consumers. Last minute changes will increase uncertainty and upset expectations based on current law.

NPRA OPPOSES FURTHER REDUCTIONS OF BOUTIQUE FUELS

Current calls for the reduction of "boutique fuels," for example, may not provide the supply-relief that many advocates think. NPRA believes that any attempt to limit the number of viable fuels in regions or nation-wide may be counter-productive, and certainly no such change would have a positive impact now or during this summer. Boutique fuels programs in many cases represent a local area's attempt to address its own air quality needs in a more cost-effective way than with RFG. While boutique fuels are often blamed for episodic price variations during limited supply disruptions in specific regions, their overall impact on local economics is a net positive when compared to a constant requirement for RFG.

Historically, the primary driver that led local areas to create boutique fuels was to attain the 1-hour ozone NAAQS. When considering fuel controls, such areas often sought to avoid RFG, either due to concerns about 1) cost, or 2) use MTBE and/or ethanol, or both. Areas that may need VOC (hydrocarbon) emissions reductions to achieve ozone attainment have been likely to favor lower RVP controlled conventional gasoline (CG) vs. RFG since low RVP CG is more cost effective. Areas that require NOx emissions reductions to achieve ozone attainment are likely to favor CG as well because both CG and RFG will return similar NOx emission reduction benefits with the implementation of the federal Tier 2 gasoline sulfur program.

Congress passed significant provisions affecting boutique fuels just last year. They have not yet been fully implemented. Clean Air Act section 211(c)(4)(C) was amended by the Energy Policy Act of 2005 requiring a joint effort of EPA and DOE to review motor fuel control choices by states, and further requiring both agencies consider the regional supply implications of such requests (see section 1541 of P.L. 109-58). Before granting a waiver of federal preemption, the Administrator of EPA is required, after consultation with the Secretary of Energy and after notice and comment, to find that the fuel control choice will

not cause fuel supply or distribution interruptions, or have a significant adverse impact on fuel producibility in the affected area or contiguous areas. NPRA strongly supports this important focus on supply-side impacts. Congress should allow time for implementation of this new system before contemplating any changes.

The Energy Policy Act of 2005 includes another provision addressing boutique fuels. Under this provision, EPA may not approve a motor fuel in a new SIP if it increases the number of approved fuels as of September 1, 2004, and unless EPA finds, after review and comment, that the new fuel will not cause supply or distribution disruptions or have an adverse impact on fuel producibility in the affected area or in contiguous areas, and unless the fuel was already in use in the same PADD (with the single exception of summer 7.0 psi RVP conventional gasoline). By November 2005, EPA was to publish a list in the Federal Register of motor fuels in all SIPs as of September 1, 2004, by state and PADD for public review and comment. Additionally, the Act requires a report by August 2006 of a joint EPA/DOE study on boutique fuels, including effects on air quality, fuel availability and fungibility. These provisions have not yet been implemented.

Congress should avoid further confusion and potential disruption in the fuels market and rely on the scheduled joint EPA/DOE study on boutique fuels as a basis for any future legislative initiatives on this subject. In short, NPRA supports further study of the boutique fuels phenomenon as outlined in last year's energy bill, and urges Congress to resist imposition of any additional motor fuel specification changes. Further changes in motor fuel specifications in the 2004 - 2010 timeframe may very well result in additional, unwarranted supply constraints to a situation which already provides significant challenges due to the import of, Tier 2 gasoline sulfur regulations, ultra-low sulfur diesel regulations, revised mobile source air toxic rules, and the impact of revised ozone and particulate matter National Ambient Air Quality Standards, and others (see Attachment III).

Certain actions could be taken by Congress to address the proliferation of fuel formulas without mandating specification changes. Key drivers for future boutique fuel proliferation are the 8-hour ozone NAAQS and PM 2.5 NAAQS. Some areas will doubtless seek to add fuel controls as they develop State Implementation Plans to demonstrate attainment. Many are looking at additional unique requirements for local areas, especially where stationary

source options are limited or can't be implemented quickly. Thus, states look to short-term, localized fuel controls to meet excessively compressed NAAQS attainment deadlines. These deadlines are not aligned with federal controls, either existing or in the early stages of implementation (Tier 2 Gasoline & Vehicle standards, Heavy Duty Highway and Non-road Diesel Sulfur standards, etc.). This situation not only prevents states from counting real and significant emission reductions in the time required for compliance, but also adds considerable and unnecessary cost to the overall NAAQS program.

States and local areas need more time to demonstrate attainment or credit for existing regulatory requirements that will deliver emission reductions over time. Congress should direct that states be allowed credit for emission reductions through 2020 resulting from federal fuel control programs already in place. If this is done, much of the interest in and perceived need for states to enact new motor fuel controls will be alleviated.

Further, it is evident that variations in motor fuels may be reduced with implementation of current regulatory programs. For example, EPA published the Mobile Source Air Toxics Phase 2 proposal (71 FR 15804; 3/29/06). The primary feature is a proposed reduction in the average annual benzene content in all gasoline (conventional gasoline plus RFG) to 0.62 vol%. This would eliminate a current toxics control distinction between RFG and CG. Furthermore, the recent removal of the oxygen content requirement for federal RFG reduces the difference between winter RFG and winter CG and between summer RFG and summer 7.0 psi RVP CG. In addition, the average sulfur content of RFG and CG is identical because of the federal Tier 2 Gasoline Sulfur program. Therefore, differences between RFG and CG are diminishing, which should reduce the attractiveness of new boutique fuels as alternatives to RFG.

In sum, NPRA does not support legislation to address boutique fuels that changes existing specifications. A new legislative menu of motor fuel choices, which NPRA does not support, should in any case recognize investments already made by the petroleum industry to produce boutique fuels and comply with existing mandates. Failure to consider and balance supply implications, as well as air quality impacts, risks making the current supply situation worse.

EPA SHOULD PROMULGATE RFS STANDARDS THIS YEAR/ CONGRESS SHOULD PREEMPT STATE ETHANOL MANDATES

The Energy Policy Act of 2005 includes a renewable content requirement for motor vehicle fuels, the Renewable Fuels Standard (RFS) provision. The RFS will be administered by EPA and require the increased use of ethanol, biodiesel or other renewable fuels in motor fuels. It is an obligation for gasoline refiners, blenders, and importers. EPA published a Direct Final Rule with a limited set of RFS standards for 2006 that included collective compliance, not individual refinery compliance. This Direct Final Rule was effective on February 28, 2006.

NPRA advocates a program that is understandable, allows unambiguous enforcement, promotes adequate flexibility for refiners and gasoline importers, and is developed with full recognition of its impact on energy supplies. The comprehensive RFS final rule, effective in 2007, should be in place as early as possible before January 1, 2007. Meeting this timetable may be difficult because the Agency has not yet released a proposal for public comment.

Congress set limits on the proliferation of new fuels in the 2005 Energy Policy Act. Unfortunately, new state ethanol, biodiesel or renewable fuel mandates can evade Congressional efforts to limit the number of fuels. These programs should be preempted by the federal Renewable Fuel Standard pending the same energy supply impact analysis required for changes in local gasoline and diesel standards. Congress and the Administration should not grant a free pass to new ethanol and biodiesel mandates that proliferate fuel requirements and negatively impact supply.

OTHER RECOMMENDED POLICY ACTIONS

Congress can and should take appropriate action to help refiners meet the transportation fuel needs of the American public. Regardless of industry profitability, the simple fact remains that supply and demand for refined products are in an extremely tight balance. The refining industry is still working to recover fully from the impact of Hurricanes Rita and Katrina. Additionally, several upcoming regulatory requirements should be carefully monitored for adverse supply impacts. Necessary and prudent actions include the following:

- **Make increasing the nation's supply of oil, oil products and natural gas a number one public policy priority.** Now, and for many years in the past, increasing oil and gas supply has often been only a secondary concern of policymakers. Oil and gas supply concerns have played second fiddle to whatever policy goal seemed politically popular at the time. As discussed above, the 2000 NPC study of the refining industry urged policymakers to pay special attention to the timing and sequencing of any changes in product specifications. Failing such action, the report cautioned that adverse fuel supply ramifications may result. We repeat that this warning has been widely disregarded.

- **Resist tinkering with market forces, including imposition of "windfall profits" taxes, LIFO repeal or elimination of foreign tax provisions.** Market interference that may initially be politically popular leads to market inefficiencies and unnecessary costs. Policymakers must resist turning the clock backwards to the failed policies of the past. Experience with price constraints and allocation controls in the 1970s demonstrates the failure of price regulation, which adversely impacted both fuel supply and consumer cost. The state of Hawaii has just cancelled its less than one-year old gasoline price regulation because it led to higher prices and supply uncertainty. A windfall profits tax would discourage investment in refineries, which is needed to expand domestic production capacity and produce cleaner fuels.

- **Remove barriers to increased supplies of domestic oil and gas resources**. Refineries and other important onshore facilities have been welcome in limited areas throughout the country, including the Gulf Coast. However, policymakers have restricted access to much-needed offshore oil and natural gas supplies in the eastern Gulf and off the shores of California and the East Coast. These areas must follow the example of Louisiana and many other states in sharing their energy resources with the rest of the nation. This additional supply is sorely needed.

- **Expand the refining tax incentive provision in the Energy Act.** Reduce the depreciation period for refining investments from 10 to five years in order to remove a current disincentive for refining investment. Consider allowing expensing under the

current language to take place as the investment is made rather than when the equipment is actually placed in service. Alternatively, the percentage expensed could be increased as per the original legislation introduced by Senator Hatch.

- **Review permitting procedures for new refinery construction and refinery capacity additions.** Seek ways to encourage state authorities to recognize the national interest in increased domestic refining capacity by reducing the time needed to permit expansions and other refinery projects.

- **Keep a close eye on several upcoming regulatory programs that could have significant impacts on gasoline and diesel supply.** They are:

  - *Design and implementation of the credit trading program for the ethanol mandate (RFS) contained in the recent Energy Act. This mechanism is vital to ensure smooth implementation without adverse effects on gasoline supply. Refiners have been working closely with EPA to accomplish this key task.*

  - *Implementation of the ultra low sulfur diesel highway diesel regulation. The refining industry has made large investments to meet the severe reductions in diesel sulfur that take effect in June. We remain concerned about industry's ability to produce the necessary volumes and the distribution system's ability to deliver this material at the required 15 ppm level at retail. If not resolved, these problems could affect America's critical diesel supply. Industry is working closely with EPA on this issue, but time left to solve this problem is growing very short.*

  - *Phase II of the MSAT (mobile source air toxics) rule for gasoline. Many refiners are concerned that the proposed regulation could be overly stringent and impact gasoline supply. We hope that EPA will finalize a rule that protects the environment and avoids reducing gasoline supply while protecting the environment.*

- *Implementation of the new 8-hour ozone NAAQS standard. The current implementation schedule set by EPA has established ozone attainment deadlines for parts of the country that will be impossible to meet. EPA has not made needed changes that would provide realistic attainment dates. The result is that areas will be required to place sweeping new controls on both stationary and mobile sources in a vain effort to attain the unattainable deadlines. The CAIR rule and ULSD diesel program will provide significant reductions to emissions within these areas when implemented. These reductions will not come soon enough to be considered unless the current unrealistic schedule is revised. If not, the result will be additional fuel and stationary source controls which will have an adverse impact on fuel supply and could adversely affect U.S. refining capacity. This issue needs immediate attention.*

NPRA's members are dedicated to working cooperatively with government at all levels to ensure an adequate supply of transportation fuels at reasonable prices. But we feel obliged to remind policymakers that action must also be taken to improve energy policy in order to increase supply and strengthen the nation's refining infrastructure. We look forward to answering the Committee's questions.